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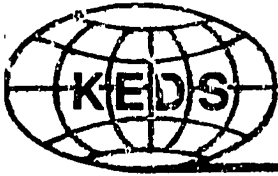

KENYA EXPORT DEVELOPMENT SUPPORT

KENYA EXPORT POLICY BASELINE STUDY

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INTRODUCTION

This report is a baseline analysis of Kenya's export policies. It was prepared for the Kenya Export Development Support (KEDS) Project of the U.S. Agency for International Development. The KEDS project supports Kenya's efforts to expand the country's exports of nontraditional products through increasing investments and developing a more favorable trade environment. The purpose of the analysis is to provide an overview of Kenya's export policy framework and to identify aspects of the policy framework that may be target areas for future reform.

The Government of Kenya has taken significant steps to enhance the policy and operating environment for the country's export sector. Programmes that remit duties and value-added tax (VAT) on imports used for producing exports and that permit foreign exchange retention by exporters are just two of several recent reforms. The changes have made exporting from Kenya more profitable and more competitive.

This baseline analysis looks at two parts of the policy framework: specific export promotion incentives and the export environment as a whole. Specific export promotion incentives include programmes for duty and VAT remission, manufacturing under bond, export processing zones, export financing, and foreign exchange. The export environment is described in terms of licenses and approvals, import/export clearing, transportation, tariffs and taxes, and export services.

For each of the above topics, this report lists key descriptive characteristics of the incentive program or of environmental conditions. Next, problem areas are identified that appear to limit effectiveness of programmes or the efficiency of exporting. Third, recommendations are proposed to address many of the problems identified.

In conducting this baseline analysis, the study team spent two weeks in Nairobi meeting with government officers, exporting firms, and related agencies and associations (the interview list is attached as an annex). Input from government officials, particularly in the Ministry of Finance, was valuable in providing information about current government policies and problems encountered in implementing recent policy changes. Private exporting firms interviewed included a cross section of agricultural and manufacturing exporters and exporters participating in each of the export promotion programmes. These private exporters and associations provided information about their experience — positive and negative — in exporting from Kenya.

The study team also reviewed many recent documents on Kenyan exporting (references are attached as an annex). Although a considerable amount of work has been done on Kenyan export policies, many of the recent policy changes implemented by the government have rendered previous reports obsolete.

Descriptions of how incentive programs work and of the problems in administering the programs differed depending on the perspective of interviewees — whether the individual was from government, a private sector firm, or an association or agency. Inconsistencies were also found in descriptions of and problems concerning the overall export environment. The study team attempted to obtain information from as many sources as possible to resolve inconsistencies. Still, some of the problems listed in the following sections reflect the perspective of one sector only.

The report's recommendations address each main problem area. Not all the recommendations are immediately feasible, however, and some can be addressed only in the long run. For example, the

transportation and tax structures in some small, successful export-oriented countries are presented more as targets for the future than as immediate objectives. On the other hand, several recommendations can be implemented rapidly. Changes were in progress during the study team's field visit and are already being implemented by the government.

An Export Policy Baseline Matrix following the text summarizes the recommendations arising from the baseline analysis. The matrix presents recommendations proposed for each of the policy areas and assesses the impact of the recommendations, the ease of implementation, the proposed action for implementation, and the schedule for action. Proposed actions include activities by the long-term technical assistance (LTTA) team and the short-term technical assistance (STTA) consultants, and use of project training and workshop funds. Some proposed actions cannot be addressed directly with project resources, such as recommendations for new Ministry of Finance or Central Bank of Kenya directives. This matrix is intended to serve as a baseline for monitoring changes in Kenya's export policy framework regardless of the source of change, and also as a guide for using the technical assistance resources of KEDS to target key policy areas.

EXPORT POLICIES AND POLICY ISSUES

EXPORT PROMOTION INCENTIVES

I. DUTY/VAT REMISSION (DVR)

a. Description

- The Duty/VAT Remission program (DVR) is a scheme to remit duties and VAT payments paid by exporting firms on inputs imported for the production of exports.

- Prior to importing the inputs, firms apply for DVR using a C56 form on which they specify items to be imported, the input/output relationships of imports and exports, and the amounts of duties and VAT to be remitted. Applications can be made for either individual consignments or for established exporters, for six month operating periods.

- Importers must take out a security bond (or insurance for bond) in favor of customs in the amount of 75 percent of the duty and of the amount of VAT for remission.

- Firms submit a C57 reconciliation declaration along with supporting documentation after exporting output or after expiration of approved operating period, which has recently been extended to nine months.

- Within three months of EPPO accepting the properly completed C57 form, bonds are to be automatically canceled.

- Firms are audited to verify information on reconciliation forms.

- Products receiving export compensation payments are not eligible to obtain DVR

- The Export Promotion Programmes Office in the Ministry of Finance serves as a one-stop-shop for processing and approving DVR applications. A Ministry of Commerce officer serves in the EPPO office to speed approval of import applications for DVR applicants.

b. Problems

- DVR approvals have taken up to several months to obtain in the past due to errors on the parts of both EPPO and applicants. This has discouraged a number of potential DVR applicants from participating. Approvals now take much less time and EPPO has committed to turn applications around in less than a week.

- Audits of reconciliation forms were not conducted promptly and had taken several months to complete in the past. EPPO is working to reduce this delay and has recently established a three month limit for conducting audits.
- As a result of audit delays, security bonds are not canceled promptly forcing firms to carry these bonds over. A number of firms complained about the costs or carrying these bonds.

- DVR promotions are limited to direct exporters importing inputs. Indirect exporters and non-importing exporters do not qualify for benefits.

- Firms with multiple imported inputs and irregular production schedules have difficulty in keeping proper track of imports and exports for reconciliation forms.

- VAT remissions on domestically purchased inputs for export production are handled by the VAT Commissioner instead of EPPO and many firms complain that VAT remissions tend to be very late.

c. **Recommendations:**

- EPPO institutional strengthening - e.g. staff training, outreach programs, data base management and computerization, and internal procedures manuals. A number of these institutional strengthening steps are underway with the assistance of the KEDS EPPO advisor and the EPPO needs assessment study.

- Examine feasibility of further reductions in the required coverage of security bonds (depending on forfeiture rate of security bonds).

- Security bonds should be canceled more quickly - after review and acceptance of the reconciliation forms instead of after audits. If later audits uncover errors, firms would be charged outstanding duties with interest (and penalties if appropriate).

- Provide assistance to firms applying for DVR in completing forms and in record-keeping for sequential DVR applications and reconciliations. This may include assistance through the Private Enterprise Management Unit and developing new recording systems or software for firms.

- Provide assistance to VAT Commissioner to speed up approvals and payments of VAT remissions. This may entail technical assistance and integration with EPPO green channel services to DVR applicants.

- Phase in DVR benefits for indirect exporters over time. Begin with an analysis for phasing options so that the DVR scheme and EPPO are not overloaded with the complexity of an indirect system. Announce plans for expanding DVR scheme as soon as practicable along with an implementation schedule so firms may plan accordingly. Perhaps begin phased expansion by permitting firms importing and selling directly to exporting firm to apply for DVR.

II. MANUFACTURING UNDER BOND (MUB)

a. Description

- The Manufacturing Under Bond program exempts qualifying firms form paying import duties and VAT on imported inputs and capital equipment. MUB firms are also exempted from paying import licensing fees if imports are provided by suppliers with no foreign exchange requirements. Firms are also allowed to set off 100 percent of investment expenditures against corporate income taxes. Firms must export all of their output to qualify for MUB status.

- MUB factories are bonded by the Customs Department and have customs officers based on the premises. The officers monitor dissemination of imported inputs from stores and shipment of exports. Imported inputs are kept in stores under double key locks accessible jointly by customs officers and factory management.

- MUB firms must post security bonds with the Customs Department in the amount exempted duties and VAT for imports and exports in transit, for imports in stores, and for machinery in factories.

- Approvals and clearances are facilitated by the Investment Promotion Centre (IPC) operating as a one-stop-shop for MUB firms.

- There have been 59 MUB applications to IPC. Of these, there are 19 operating firms, six applications have been rejected, and of the remaining 25, about 30 percent are expected by IPC to begin operations. The others have failed to obtain financing or have lost their markets.

b. Problems

- Customs officers at MUB factories are sometimes unavailable when management needs access to stores to release imported inputs. Availability has also been a problem when outputs must be examined prior to shipment for export. Delays in production and shipments result.

- Factories needing to extend working hours in evenings or weekends to meet production targets must pay overtime to customs officers.

- Security bonds for imports, exports, and capital equipment are expensive for firms to carry.

- MUB firms operate under duplicate systems of customs control: physical control of duty exempted items by customs agents, and documentary control with import and export forms and input/output statements.

- MUB license fees of KShs 40,000, which are greater than non-MUB licensing fees, cover the costs of posting customs officers in factories. However, these postings may be unnecessary due to redundant controls.

- MUB firms do not receive the types of tax incentives available for firms in Export Processing Zones (EPZ) in spite of producing exclusively for export.

- The approval process has been slow for some applicants even with the IPC one-stop-shop. Approvals have taken several months longer than expected.

- Some firms said that Central Bank of Kenya (CBK) approvals required on a number of items during the approval process delayed approvals and seemed unnecessary.

c. **Recommendations:**

- Phase out physical control systems to eliminate duplicate controls. Rely on documentary controls of import, export, and input/output documents with occasional customs inspections.

- As a second-best alternative, increase access to imported stocks with more flexible administration of stores in factories. For example factories can keep two stores; one bonded (double-key) store and one unbonded store. Management could keep approximately one weeks supply of inputs in the unbonded store. Customs officers would come on a regular schedule and on request to release inputs from the bonded to the unbonded stores.

- Reduce the cost of MUB licenses after changing the control system to one that does not require posting of customs officers on site.

- Reduce the necessary coverage of security bonds from 75 percent to 50 percent.

- Grant MUB firms tax incentives roughly equivalent to EPZ firms.

- Undertake an Outreach Program to MUB firms. For example, conduct periodic problem-solving workshops between public and private sector participants as a continuation of the successful workshop already held.

III. EXPORT PROCESSING ZONE PROGRAM (EPZ)

a. Description

- Export processing zone (EPZ) firms are given the following incentives: exemption from duties and taxes on imported raw materials, intermediate goods and capital equipment; exemption from exchange controls including unlimited repatriation of capital and profits; 10-year tax exemption from corporate income taxes; corporate taxes limited to a maximum of 25 percent for the following 10 years; and streamlined investment approval and administrative procedures.

- An autonomous Export Processing Zone Authority (EPZA) has been established to oversee the program and operate as a one-stop-shop for approvals and clearances.

- A private EPZ/industrial estate has been established in the Nairobi area and hosts four operating firms; the remaining first phase factory buildings (12 additional tenants) are already committed. A second private EPZ is being built in Nakuru.

- A public sector EPZ/industrial estate at Athi River is more than half complete and is expected to become operational in the first half of 1993.

- A single private sector factory EPZ is being built in Ruraka and a second public sector EPZ has been approved in Mombasa. Another private EPZ is being considered in Nakuru.

2. Problems

- A full Board of Directors has yet to be named to the EPZA which has prevented it from resolving several important policy and procedural issues.

- The EPZA has yet to formalize an organizational structure and some staff positions remain unfilled.

- It is unclear whether the EPZA will assume the potentially conflicting roles as both regulator and developer/operator of EPZ/industrial estates.

- Clear eligibility criteria have yet to be established for the investment approval process.

- Procedures for domestic sales and purchases remain unclear, and the need for expensive and time-consuming in-transit security bonds is likely unnecessary.

- The delineation of responsibilities between EPZA and the IPC regarding promotional activities remain unclear.

- Questions remain regarding the legality of single-factory free zones and commercial free zone operations.

- The EPZA has yet to establish a regulatory framework for oversight of the EPZ regime.

- EPZA staff are relatively unfamiliar with EPZ programs.

3. Recommendations

- Further review and revision of EPZ regulations (as per EPZ Needs Assessment Study) to remove remaining ambiguities - with special attention to questions about single factory EPZs.

- Establish internal EPZA procedures for the designation and oversight of zone developers and enterprises.

- Prepare competitive assessment of potential EPZ developers and enterprises.

- Prepare "Investor Handbook" for potential EPZ developers and enterprises.

- Develop a multi-functional MIS system.

- Conduct staff training workshops and undertake exposure tours for officials dealing with the EPZ regime.

- Replace in-transit security bonds with escorts by Customs officers for transportation over short distances.

IV. EXPORT COMPENSATION (EC)

a. Description

- The Export Compensation (EC) Scheme is intended to compensate exporting firms for high cost of imported inputs due to import duties and the high cost of domestic inputs due to protection of local industries.

- Firms receive compensation payments amounting to 18 percent of FOB value of exported products approved for EC.

- To receive EC, products must be approved by the Ministry of Finance and be registered as eligible for EC. After obtaining initial registration, applications for payment after exporting are simple to complete.

- EC exporters can now claim the compensation immediately upon export of product and have 90 days thereafter to prove receipt of foreign exchange. A bond is posted to cover the amount of foreign exchange during this period.

- The EC scheme is relatively easy to administer for exporters and would also be expandable without great difficulty to indirect exporters.

- Approximately 300 firms and 1333 products are currently registered as eligible for EC.

- The level of EC compensation has been reduced from 20 percent to 18 percent and there are indications that compensations will be reduced further in the future.

b. Problems

- EC is countervailable under GATT and both Rwanda and Tanzania have imposed countervailing tariffs on some products receiving EC in Kenya.

- There is no relationship between the higher costs exporting firms incur due to duties, etc. and the size of their EC payments.

- EC payments to many firms have been very late - some over one year. Delays arose in processing forms for compensation and in availability of funds to pay claims. Payments are made more promptly now with the new provisions for immediate claims and 90 days to present receipts as mentioned above.

- As "payments" to qualifying firms, EC payments are subject to availability of funds in Treasury. This is in contrast to exemptions from duty and VAT payments under the DVR program.

- The EC and DVR programs are redundant because both are intended to promote exports by easing financial burdens on exporters arising from high import duties on their inputs. However, the DVR program is better targeted in compensating for the duties and covers a much broader range of products.

c. Recommendations

- For firms in the EC scheme, payments should be accelerated. The Ministry of Finance should ensure that payments are made within a given short time period after acceptance of EC claims. This has been addressed in part with the new payment and bond provisions described above.

- Phase out the EC scheme over time by continuing to lower the compensation percentage firms receive for exports. The timing of the phase-out should correspond with strengthening the DVR program though actions recommended above. As EC benefits are eroded, firms will shift over to the DVR program from the EC scheme.

- Undertake an Outreach Program to EC firms. For example, conduct periodic problem-solving workshops between public and private sector participants as was done once with MUB firms.

- Provide assistance to firms to facilitate rapid switching from EC scheme to DVR programme as the EC scheme is being phased out.

V. EXPORT FINANCING

a. Description

- The CBK preshipment export financing program is intended to increase credit available through commercial banks to exporters to finance exporting operations.

- The CBK offers a rediscounting facility to commercial banks for qualifying loans to exporters.

- The CBK has also relaxed various banking regulations for commercial banking, such as liquidity requirements, lending criteria, and credit ceilings, to encourage banks to increase lending to exporters

b. Problems

- The CBK rediscounting facility is underutilized by commercial banks because the discount rates are not attractive. However, given the general level of credit availability in Kenya, exporting firms are able to obtain financing as required. Some banks do offer special terms to exporters such as marginally lower interest rates (18 percent for KShs 500,000 loans as compared to 19 to 20 percent for equivalent non-exporter loans). Banks also offer other services to exporters such as overdraft facilities, negotiations under letters of credit, and the purchase of bills of exchange.

- Small and new firms must meet collateral requirements for borrowing which tend to be high in Kenya.

- Lending regulations for commercial banks are still restrictive in some special areas of providing credit for exporters such as permitting post-shipment financing, financing for indirect exporters, and terms for transactions in export related financial instruments.

- Insurance and guarantee programs for some important types of Kenyan exports - such as for non-traditional exports and to regional markets - do not exist.

c. Recommendations

- Continue steps toward relaxing banking regulations to permit commercial banks flexibility in meeting financing needs of exporters.

- Classify export related financial instruments as having full status as financial instruments for banking and exchange.

- Facilitate establishment of insurance markets for Kenyan exports both by local and foreign insurance companies.

- Avoid subsidy programs for export credit that do not address specific credit market failures and that would violate trade agreements.

VI. FOREIGN EXCHANGE

a. Description

- Under a recent CBK circular, exporters can retain 100 percent of export earnings in foreign exchange accounts to finance business related activities including import of goods and services, business travel, advertising and marketing, international debt service, and remittance of dividends of foreign-owned enterprises.

- Most exporting firms have already opened retention accounts with commercial banks though many have not yet received their first payments in foreign currencies into the accounts.

- Foreign exchange in the accounts may be sold at market exchange rates to other authorized recipients to make eligible payments as listed above.

- Monthly bank statements of account holders must be forwarded to the CBK

- Earlier, CBK initiated the Forex C, a bearer certificate for the purchase of foreign exchange from the CBK. Holders of forex may sell it to CBK at and obtain certificates entitling the bearer to repurchase the same amount of forex on demand at prevailing rates.

- Forex C's are traded in an open Nairobi market and have been trading at premiums of about 25 to 45 percent.

- CBK foreign exchange will no longer be available at the cheaper official rate for importers of goods in import schedules 3B and 3C. Foreign exchange for these imports can be obtained in the forex retention market or the forex C market.

- Forex in retention accounts cannot be used to purchase Forex C's.

b. Problems

- Quantities of forex in retention accounts will be small for a while since it will take some time for exporters to accumulate earnings in their accounts

- Uncertainties remain on the utilization of forex in retention accounts and the disposition of funds not utilized in authorized uses.

- Limits on the uses of forex in retention accounts and various account regulations appear restrictive.

c. Recommendations

- Provide clarification of foreign exchange retention account regulations, including account utilization regulations and exchange rates for conversion to Kenyan currency.

- Relax restrictions on overdrafts and reconciliations and CBK reporting requirements for retention accounts to be more in line with regulations concerning other accounts.

- Relax restrictions on uses for forex in the retention accounts - to allow the purchase of Forex C's, for example.

- As a second-best alternative, give greater flexibility for forex utilization by holders of retention accounts and relax regulations concerning retention account management by commercial banks.

- Consider establishing a swap facility to overcome short-term scarcity of foreign exchange in the open markets. The swap facility could be directed toward small exporters and start-up operations who have no accumulated forex or no access outside of the Forex C market.

EXPORT ENVIRONMENT

I. LICENSES AND APPROVALS

a. Description

- Imports to Kenya are brought into the country under licensing schedules administered by the Ministry of Commerce. The schedules - 1, 2, 3A, 3B, and 3C establish priority of imports and eligibility for foreign exchange allocations.

- Imports in schedule 3B and 3C are not eligible for receiving foreign exchange from GOK. The import licenses for schedule 3B and 3C goods are to be issued automatically.

- Import license fees amounting to two percent of the value of imports are charged on all imports - except MUB imports paid for by external companies.

- Licenses and approvals are facilitated by EPPO, IPC, and EPZA which operate as one-stop-shops for firms in the DVR, MUB, and EPZ programs.

- Approvals are needed for some imports by sectoral ministries. Approvals are most commonly required by the Ministry of Agriculture (MOA) for the importation of agricultural goods.

- Approvals are needed from Central Bank of Kenya under various circumstances - for example for imports qualifying to obtain foreign exchange allocations at the official exchange rate.

- Only a short list of 19 strategic products require export approvals.

b. Problems

- Import licenses still can take too much time to obtain from the MOC. The turn-around time is not standard for goods being imported under similar circumstances.

- Import licenses for goods imported without requiring foreign exchange allocations are not always automatic.

- It is unclear why import licenses are required for items imports to be licensed automatically. All information required is contained on the standard customs documents.

- It is unclear why CBK needs to approve licenses not requiring foreign exchange.

- Import license fees are charged to cover the cost of inspections, however, the two percent fee seems larger than necessary for inspection costs. As an implicit duty, it is at odds with the DVR program.

- MOA approvals often incur long delays for no clear reason.

- Investment approvals obtained through the IPC can sometimes take too long. They should take no more than one month.

c. Recommendations

- Accelerate investment and license approval procedures for exporting firms.

- Eliminate import licenses for Schedule 3B goods.

- As a second-best alternative, make import licenses for Schedule 3B and 3C items truly automatic and with a maximum one day turn around. Also make licensing automatic for Schedule 1,2, and 3A items imported without GOK foreign exchange allocations.

- Eliminate the need for CBK approvals for import licenses and the two percent import license fee for inspections. CBK input should be in drawing up the import licensing schedules.

- At a minimum, link fees to the actual costs of inspections and processing applications. As a result, fees will vary by product and size of order but will tend to be less than two percent of import value. This can be implemented by broad categories or products to keep administration costs down.

- Accelerate sectoral ministry (e.g. MOA) approvals. First ensure that approvals and inspections are only required if necessary, e.g. for protection of domestic agriculture. Second, specify turn maximum turn-around time for approvals - three days. Third, add ministry approvals to EPPO, IPC, and EPZA green channel activities.

II. CLEARANCE OF GOODS

a. Description

- As described elsewhere in this report, delays in clearance of goods varies considerably depending on the mode of transportation, direction of the goods (import or export), the export program the company operates under, etc.

- Delays in receiving imported inputs are not due solely to clearance bottlenecks. The actual clearing of goods phase typically takes 2-3 days, delays also result from railway and port inefficiencies. Nonetheless, countries with competitive non-traditional export programs generally achieve customs clearance in considerably less time.

- Clearing delays are much more problematic at the port than at the airport.

- The MUB and EPZ programs utilize both physical and paper controls to ensure that there are no leakages of goods into the domestic economy. Because customs officials are constantly on the premises at these factories, final clearance is made at the factories which reduces possibilities for pilferage and accelerates procedures.

- For export compensation and the DVR schemes, Customs operations are done primarily through audits and no Customs personnel are based at these companies.

- All sea freighted imports are cleared by multiple agencies, including: customs, the Kenya Port Authority (which is responsible should any goods be pilfered), three police organizations (uniformed, CID, and special branch) and Ministry of Commerce trade officers.

- Because of fears of loss of duty and VAT revenue, imported materials are more closely monitored and therefore more liable to delays than exported goods. Manufactured exports need only be cleared by Customs and can be sealed in their containers at the factory. Horticultural exports are cleared by Customs and the Ministry of Agriculture and exporters of horticultural products believe that Customs and Ministry procedures are reasonable.

b. Problems

- Customs has been trying to become computerized without success for over two years. The computerization is necessary if Customs is to shift from the more cumbersome physical control to paper control of companies.

- In theory, the multiple agencies responsible for clearing imports are supposed to operate as a team to ensure that goods are not unreasonably delayed. In practice, the five organizations often do not operate in synchronized fashion and the unavailability of officers frequently results in delays.

- Clearing problems are greater at the port of Mombasa than at the Nairobi Inland Container Depot primarily because the five relevant organizations are better coordinated.

- While there appears to be a perception that Customs has improved in recent years, non-traditional exporters believe that Customs and other clearing officials lack understanding of the time-sensitive nature of their businesses and the costs that delays can cause.

- Corruption through the clearing process continues to be a major problem.

c. Recommendations

- Eliminate multiple inspection of imported goods. There is little need for multiple agencies to inspect imports, Customs alone is sufficient in most countries. Recommendations should be made to streamline this process.

- Eliminate inspections of imports for price and quality assurance. Government inspections are less important with imports paid for with foreign exchange obtained from Forex C markets or retention accounts and importers should bear quality risks.

- Ensure Green Channel processing of imports and exports for all export firms.

- Training of Customs officials is needed to increase Customs efficiency in dealing with exporting firms. Seminars can be conducted with officials at all levels emphasizing that Kenya is competing against other countries and that delays can throttle the growth of non-traditional exports through late shipment penalties, higher working capital requirements, excess inventory, and high administrative costs.

III. TRANSPORTATION

a. Description

- As they are involved in international trade, Kenya's exporters are highly dependent upon the availability and quality of transportation services.

- Fresh produce exporters -- given that their products are highly perishable -- are particularly in need of efficient air freight service. Moreover, fresh produce exporters are highly sensitive to air freight rates as these can comprise over 50 percent of the cif price.

- Efficient sea freight facilities and services are critical to export manufacturers as they are often working on tight delivery deadlines. Delayed shipments of inputs have sometimes caused Kenyan manufacturers to lose orders or forced them to utilize air freight for exports (air freight costs approximately 500 percent more than sea freight).

b. Problems

- Kenya Ports Authority is expensive compared to other ports. Port handling charges in Mauritius are one-fourth those in Mombasa and Dar-es Salaam is 39 percent less expensive.

- Many exporters in Kenya face delays of 1-4 weeks before their containers arrive from the port of Mombasa. Delays are encountered with Kenya Ports Authority, Customs and other inspectors, and Kenya Railways. In contrast, exporters in Dubai and Mauritius typically receive their containers within 24 hours. This is essential, as many international manufacturers operate on a just-in-time basis to reduce inventory and working capital costs.

- Port equipment is not well maintained and oftentimes a large percentage of the cranes, forklifts, and front-end loaders are not operational.

- The port staff of 10,000 is overly large and has resulted in KPA's high cost levels. In addition, there are an unnecessary number of signatures within the port for releases.

- Delays in receiving sea freighted containers is evidently largely due to problems at Kenya Railways. Although containerized traffic does receive priority, containers often face delays of two weeks before being loaded. The shortage of railway cars is part of the problem, and is attributed to use in famine relief efforts as well as poor maintenance and general inefficiency.

- Using faster road transport service, rather than the railway, is not an attractive option as containers transported by truck are opened at the port, resulting in higher levels of pilferage. Transporting by rail is also between 20 and 50 percent less expensive than by road.

- There is an insufficient amount of air freight space for fresh produce exports. The lack of incoming traffic means that chartering of air cargo is not an attractive alternative.

- Kenya Airfreight Handling Limited (KAHL) -- a wholly-owned subsidiary of Kenya Airways -- is highly inefficient. Workers are not well trained and supervision is inadequate. Although many fresh produce exporters provide their own handling services at the airport,

they are still forced to pay KAHL for this service. Damage to produce and high pilferage rates are reported problems for those who continue to use KAHL services.

- Jet fuel, which comprises 35 percent of air freight costs, costs 38 percent more in Kenya than the world market price, despite a recent reduction.

- GOK allowed competing handlers at the airport in 1991. None have emerged as yet, due in part to the lack of facilities. Most exporters do their own handling in spite of having to pay KAHL for the service.

- As a result of all these factors, Kenya's air freight rates are about 60 percent higher than those in Ghana and the Gambia.

c. Recommendations

- Privatize air and sea cargo handling facilities and services. Many ports and airports in other countries have privatized some or all of their cargo handling activities. This is an option which is apparently under exploration and could have significant impact.

- Starting November 1992, exporters not using the services of KAHL are to be freed from having to make these payments. If implemented, this will mark a major improvement.

- Provide access to JKIA for competing air freight handlers.

- Reduce jet fuel costs to internationally competitive rates.

- Permit more trucked containers to be cleared at the factory or inland container port, rather at the port itself.

- Restructure Kenya Railways to improve efficiency.

IV. TARIFF AND CORPORATE TAX POLICY

a. Description

- To correct existing distortions and make Kenyan industry more competitive, the GOK has carried out a program of import liberalization that involves the rationalization of import duties, as well as a gradual elimination of quantitative restrictions as a means of protection.

- To date, the number of tariff categories have been reduced from 25 to 12, and tariff levels have been reduced by a weighted average of approximately 5 percent over the past 2 years.

- Corporate income taxes have in recent years decreased by 2.5 percent annually bringing the current rate to a more reasonable 35 percent.

b. Problems

- Overall tariff levels remain high compared to successful exporting countries in spite of recent reductions.

- Raw material inputs not directly imported by exporters are still subject to substantial duties of approximately 35 percent and VAT of 18 percent.

- While direct exporters can receive either duty/VAT remission or export compensation (18 percent of export value for certain products) to make them more competitive, indirect exporters are not adequately addressed by these schemes.

- Even with DVR, exporters claim they still pay approximately 10 percent of import value for licenses and other fees.

- The 35 percent corporate income tax rate represents a significant improvement from previous rates but still places Kenyan exporters (outside of the EPZ regime) well above successful exporting countries such as Hong Kong, Singapore, and Mauritius.

c. Recommendations

- Continuation of the existing policies to reduce the overall level of tariffs and taxes will be the most effective and simple means to improve the export environment, particularly for small, indirect, and non-producing exporters.

V. IMPORT/EXPORT SERVICES

a. Description

- Import/export service firms would specialize in the provision of services to other firms concentrating in the production of export goods. Types of services could include: filling out application and licensing forms, getting clearances and approvals, advising on procedures, actually conducting the importing for the exporter.

- Currently, forwarding and handling firms offer some of these services to some firms in Kenya.

- On the marketing side, service firms with knowledge of foreign markets could advise on exports and purchasing of imports.

b. Problems

- Currently, most exporters conduct all of the above activities within their firms, either by senior management officers or by staff employed strictly for that purpose.

- With the exception of freight forwarders and handlers, there are no firms specializing in providing import/export services in Kenya. Freight forwarding firms conduct these activities as a side line to their main activities.

- Firms conducting these activities internally may be wasting valuable management time or resources in activities where they are not specialized and have no comparative advantage. With the example from one firm of the chief financial officer spending one day on paperwork for each consignment, considerable time is lost on non-productive activities.

- Various types of service firms would receive no benefits under the current structure of export promotion programs, such as firms that specialized in export trade (non-producing exporters) and firms that specialized in break bulking (non-exporting importers).

c. Recommendations

- Permit import/export service firms such as indirect exporters and break bulkers selling to exporters to obtain benefits under export promotion schemes.

- Encourage foreign import/export service firms to open branches in Kenya.

- Provide advice and assistance to local firms getting started in the import/export service business.

EXPORT POLICY BASELINE MATRIX

EXPORT PROMOTION INCENTIVES

I. DUTY/VAT REMISSION

Recommendations	Importance	Ease	Proposed Action	Schedule
A. EPPO Institutional Strengthening				
Staff Training	High	Moderate	Senior staff exposure tours Counterpart Training Local Short Courses	Near-Term Continuous Near-Term
Outreach Program	Medium	Moderate	Public/Private seminars Periodic problem-solving workshops Publicity campaign Mailings to Firms	Near-Term Continuous Near-Term Near-Term
Database Management and Computerization	High	Moderate	Short-term technical assistance (STTA)	Medium-Term
Prepare Internal Procedures Manual	High	Moderate	STTA and long-term technical assistance (LTTA)	Near-Term
B. Security Bonds				
Examine Reduced Coverage of Bonds	Low	Easy	Ministry of Finance (MOF) directive	Near-Term
Accelerate Audits and Cancellations	Medium	Moderate	LTTA	Medium-Term
C. Assistance to Firms in Record-keeping	Medium	Difficult	STTA to establish a system Seminars for firms	Medium-Term
D. Assistance to VAT Commissioner	Medium	Difficult	LTTA/MOF integration with EPPO one-stop shop	Medium-Term
E. Phase in DVR Incentives for Non-importing, Non-producing, and Indirect Exporters	High	Difficult	STTA to recommend the most effective and least administratively complex scheme	Medium-Term

II. MANUFACTURING UNDER BOND

Recommendations	Importance	Ease	Proposed Action	Schedule
A. Phase Out Physical Control Systems	High	Difficult	LTTA and STTA to move completely to document control	Medium-Term
B. Increase Access to Imported Stocks in Factories	High	Easy	STTA and LTTA to recommend revised MUB regulations to increase flexibility while ensuring control of stock	Near-Term
C. Reduce Cost of MUB Licenses	Low	Easy	MOF directive	Near-Term
D. Reduce Security Bond Levels	Low	Easy	MOF directive	Near-Term
E. Examine Granting MUB Firms EPZ Equivalent Tax Incentives	High	Easy	Conduct study to examine cost and impact of offering tax incentives to MUB firms	Medium-Term
F. Outreach Program	Medium	Easy	Periodic problem-solving workshops between public sector and MUB firms	Continuous

III. EXPORT PROCESSING ZONE PROGRAMME

Recommendations	Importance	Ease	Proposed Action	Schedule
A. Review and Implement Revised EPZ Regulations	High	Moderate	STTA to make recommendations addressing ambiguities such as SFFZ, local sales, and purchases	Near-Term
B. Establish EPZA Internal Procedures	High	Moderate	STTA to prepare internal procedures manual	Near-Term
C. Prepare Competitive Assessment	Medium	Moderate	STTA	Near-Term/ Update
D. Prepare "Investor Handbook"	Medium	Moderate	STTA	Near-Term/ Update
E. Develop MIS System	Medium	Difficult	STTA for establishing system followed by course	Medium-Term
F. Staff Training	High	Moderate	Senior staff exposure tour Local ST courses Counterpart training (UNDP)	Near-Term Near-Term Continuous
G. Replace Transit Bond with Customs Escort	Low	Easy	MOF/Customs directive	Near-Term

IV. EXPORT COMPENSATION

Recommendations	Importance	Ease	Proposed Action	Schedule
A. Accelerate Processing of Forms and Payments	High	Easy	MOF directive	Near-Term
B. Phase Out by Lowering Compensation Levels	High	Easy	MOF directive	Medium-Term/ Long-Term
C. Outreach Program	Medium	Moderate	MOF/LTTA to inform EC firms of changes and procedures for accessing DVR program	Medium-Term
D. Assistance to Firms	High	Difficult	STTA and LTTA to firms in switch to DVR	Medium-Term/ Long-Term

V. EXPORT FINANCING

Recommendations	Importance	Ease	Proposed Action	Schedule
A. Relax Banking Regulations for Export Financing	Medium	Easy	MOF/CBK directive	Near-Term
B. Classify Export- related Financial Instruments as Full-Status Instruments	Medium	Moderate	MOF/CBK directive	Medium-Term
C. Facilitate Insurance Markets for Kenyan Exports	Medium	Difficult	STTA to give recommendations on design and implementation	Long-Term
D. Avoid Subsidy Programs for Export Credit	Low	Easy	No action required	–

VI. FOREIGN EXCHANGE RETENTION ACCOUNTS

Recommendations	Importance	Ease	Proposed Action	Schedule
A. Provide Clarification of FERA Regulations				
Clarification of Account Uses	Medium	Moderate	MOF/CBK directive	Near-Term
Clarification of Exchange Rates for Conversion	Medium	Moderate	MOF/CBK directive	Near-Term
B. Relax Restrictions on Overdrafts and Reconciliations and CBK Reporting Requirements	Low	Easy	MOF/CBK directive	Medium-Term
C. Relax Restricted Uses of Foreign Exchange				
Allow Forex C Purchases	High	Easy	STTA to examine impact	Medium-Term
Give Greater Flexibility for Forex Utilization by Account Holders	Low	Easy	MOF/CBK directive	Medium-Term
Relax Regulations on Management by Commercial Banks	Low	Easy	MOF/CBK directive	Near-Term
D. Consider Swap Facility for Small Exporters and Start-up Exporters	Medium	Difficult	STTA	Medium-Term

EXPORT ENVIRONMENT

I. LICENSES AND APPROVALS

Recommendations	Importance	Ease	Proposed Action	Schedule
A. Accelerate Investment Approval Procedures	Medium	Difficult	Implement revised IPC law	Near-Term
B. Eliminate Import Licenses for Schedule 3B Items	Medium	Easy	MOF directive	Near-Term
At a Minimum, Make Import Licenses Truly Automatic for Schedule 3B and 3C Items	Medium	Easy	MOF directive	Near-Term
C. Eliminate the Need for CBK Approvals of Licenses and the 2% License Fee for Inspections	High	Easy	MOF directive	Near-Term
At a Minimum, Reduce Fee and Link to Costs of Actual Inspection	High	Easy	MOF directive	Near-Term
D. Accelerate Sectoral Ministry Approvals on Imports and Eliminate Where Possible	Medium	Moderate	STTA to recommend which inspections are necessary	Medium-Term

II. CLEARANCE OF GOODS

Recommendations	Importance	Ease	Proposed Action	Schedule
A. Eliminate Multiple Inspections of Goods	Medium	Easy	MOF directive	Near-Term
B. Eliminate Inspections of Imports for Price and Quality Assurance	High	Easy	MOF directive	Near-Term
C. Ensure Green Channel Processing of Imports and Exports of all Exporting Firms	Medium	Moderate	LTTA monitoring	Continuous
D. Customs Training	High	Moderate	Seminars focusing on the importance of speedy clearance for exporting firms	Near-Term

III. TRANSPORTATION

Recommendations	Importance	Ease	Proposed Action	Schedule
A. Privatize Air and Sea Cargo Handling Facilities and Services	High	Difficult	Examine viability and methods to privatize these services (World Bank)	Near-Term/ Medium-Term
For now, end practice of paying KAHL for handling services when none are provided	High	Easy	To have been implemented November 1992	Near-Term
Provide access to JKIA for competing air freight handlers	High	Moderate	JKIA authorities reorganize facilities at airport and/or allocate land to private handlers	Medium-Term
B. Reduce Jet Fuel Costs to International Levels	High	Easy	MOF directive	Near-Term
Jet Fuel Policy Study	High	Easy	STTA to examine international fuel prices and impact of lowering prices	Near-Term
C. Permit More Trucked Containers to be Cleared at Inland Container Depots	Medium	Moderate	MOF/Kenya Ports Authority directive	Near-Term
D. Restructure or Privatize Kenya Railways	High	Difficult	Examine viability and possible structures to increase rail efficiency (World Bank)	Medium-Term/ Long-Term

IV. TARIFF AND CORPORATE TAX POLICY

Recommendations	Imp.	Ease	Proposed Action	Schedule
A. Continued Reduction and Consolidation of Tax and Tariff Levels	High	Moderate	MOF directive	Continuous

V. IMPORT/EXPORT SERVICES

Recommendations	Importance	Ease	Proposed Action	Schedule
A. Permit Service Firms to Obtain Benefits Under Export Promotion Schemes	Medium	Difficult	STTA to recommend the most effective, and least administratively cumbersome scheme	Medium-Term
B. Promote Import/Export Service Companies				
Encourage Import/ Export Service Firms to Open Branches in Kenya	Medium	Difficult	PEMU conducts promotional activities	Medium-Term
Provide Assistance to Local Firms in Establishing Such Operations	Medium	Difficult	PEMU assists firms	Long-Term

INTERVIEW LIST

1. Public Sector

Ministry of Finance
Mr. Shah
Director of Monetary and Fiscal Affairs

Mrs. Kadasia
Manager, EPPO

Mr. Kirira
Deputy Secretary

Central Bank of Kenya
Mr. Birech-Koruna
Exchange Control Officer

Customs
Mr. Miano
Assistant Commissioner

Kenya Ports Authority
Mr. G.O. Odhiambo
Marketing Officer

Ministry of Agriculture
Mr. Hussein
Fresh Produce Inspection Unit

2. Private Sector

Njoro Canning
Mr. Patel
Managing Director

Kenya Horticultural Exporters
Mr. P.G. Patel
Director

Hercules Mills Limited
Mr. Boniface Ngunjiri
Administrative Manager

Wings Manufacturing Limited
Mr. Tiriok Singh Sethi
Managing Director

Synresins Limited
Mr. Arun Devani
Managing Director

Industrial Plant (E.A.) Ltd.
Mr. Gailey Sagoo
Senior Project Manager

Mr. P.S. Sandhu
Financial Director

Sunripe (1976) Limited
Mr. Hasit Shah
General Manager

Homegrown
Mr. Clive Evans

WONI Veg-Fru Exporters
Mrs. Jane N. Mutiso
Managing Director

Kibwezi Growers and Exporters Ltd.
Frida M. Muya
Export Manager

Sarcross Agencies Ltd.
Mr. J.K. Chepkwony
Managing Director

Sameer Industrial Park
Ms. Samina Rama

Standard Chartered Bank Kenya Ltd.
Mr. Dominic M. Kavuu
Head Credit Management

Mr. Sharad Dave
Trade Finance Office

Airlink Limited
Ms. Rashika Ndanu
Marketing Sales Executive

MacKenzie Maritime
Mr. Colin Hainsworth
Managing Director

Mr. Benjamin J. Mwangi
Manager, Sales & Marketing

Mitchell Cotts Kenya
Mr. Solomon M. Anampiu
Managing Director

3. Agencies and Associations

Fresh Produce Exporters Association
Mr. Kasanga Mulwa
Chairman

Mrs. Rebecca Kamoing
Executive Officer

Horticultural Crops Development Authority
Mr. Martin A.S. Mulandi
Managing Director

Investment Promotion Centre
Mr. Ben K. Nzioke
Project Manager

Mr. Luka E. Obbanda
Head of Polict Dept.

Kenya Association of Manufacturers
Mr. Kuria
Chairman

Kenya National Chamber of Commerce
Mr. Omosi
Director of Trade

4. Others

U.S. Agency for International Development
Mr. Stafford Baker
Chief, Private Enterprise Office

Mr. Migwe Kimemia
Export Policy Advisor

Ms. Anne E. Inserra
Evaluation Officer

Kenya Export Development Support
Mr. Paul C. Guenette
Chief of Party

Ms. Karen A. Potter
Export Development Advisor

Mr. Adrian A. Strain
Export Promotion Advisor

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TERMS OF REFERENCE

I. PURPOSE

The following scope of work outlines the proposed technical approach for the execution of a baseline assessment of the export policy framework in Kenya. This study is to be conducted as an element of the work program of the Kenya Export Development Services (KEDS) project, by staff members of Development Alternatives, Inc. (DAI) and The Services Group (TSG). (Hereinafter referred to as the "Study Team".) It will serve as basis for USAID/Kenya to evaluate the progress that is made in the area of policy reform during the life of the KEDS project.

II. BACKGROUND

The Government of Kenya (GOK) has taken major steps toward the enhancement of the policy and operating environment for the export sector in Kenya. In particular, over the past two years, an export processing zone (EPZ) program has been established and operationalized, constraints upon the firms engaged in manufacturing-under-bond have been identified and measures proposed to address them, and importantly, major policy changes have been enacted to facilitate much-needed access to foreign exchange, through the launching of the "FOREX-C" program, as well as recent announcement of foreign exchange retention for nontraditional exports.

Given the overall goal of the KEDS project to stimulate and support the development of the export sector in Kenya, and the critical importance of a supportive national policy environment to the achievement of this objective, it is a priority at this juncture to develop a "profile" of the current policy environment as it affects the export sector. The Study outlined below will serve as a benchmark from which the USAID/Kenya can:

- obtain an accurate and up-to-date profile of the existing export policy framework;
- identify strengths and weaknesses of the framework and thereby target areas in need of further reform;
- monitor the progress that is made in terms of both reform of the policies themselves and their implementation; and,
- evaluate the impact of the KEDS project on the export policy environment, as the work program is carried out.

The specific elements of the Study's Scope of Work, as well as, its staffing and implementation are outlined below.

III. PROPOSED SCOPE OF WORK

The Export Policy Baseline Study will serve as a reference point for the KEDS team throughout Project execution, providing the basis to fine tune, direct and evaluate the policy-related activities of the work program. It will be undertaken under the direction of the KEDS Export Promotion Advisor (EPA),

Mr. Adrian Strain, but will also draw upon the input of the two KEDS Export Development Advisors. Key tasks to be conducted include the following:

Task 1: Orientation and Data Collection

The Study Team will begin its work with the collection of relevant data and written analyses of the policy environment. Attention will be directed toward obtaining detailed information drawn from the recent donor work with the GOK. Through these efforts, the Study Team will not only obtain an understanding of the current export policy setting, but garner input for developing a comprehensive matrix of the objectives, substance, and timing of planned policy reforms by the GOK.

The investigations undertaken in this area will be facilitated by the EPA, who has been working since the onset of the KEDS project with the Ministry of Finance (MOF) in identifying areas in need of policy reform in support of the export sector. Discussions will also be held with MOF officials, USAID/Kenya, and other donor agencies, as appropriate.

Task 2: Meet with Leading Export Sector Organizations

Given the programmatic scope and focus of the KEDS project, the Study Team will be well-positioned to collect data from those Kenyan institutions and organizations that serve as advocates for the export sector. For example, working with the Export Processing Zone Authority, they will identify and utilize whatever data and analyses that are available regarding the exiting policy and implementation framework for EPZ designates -- users, developers, and operators.

Likewise, information will be collected from private sector associations such as the Kenyan Association of Manufacturers and Kenyan Chamber of Commerce and Industry. Several of these organizations are engaged in ongoing policy monitoring efforts of their own which will prove invaluable to the data collection and analysis of the Study Team.

Task 3: Investigate Policy Framework at the Firm Level

The Study Team will also draw upon the guidance of the EPA, other KEDS in-country personnel, and the export organizations cited above, to identify a sampling (10-12 firms) of exporters for in-depth interviews regarding the existing policy environment. These interviews will be cross-sectoral, including firms engaged in such activities as non-traditional agricultural production for export, and agro-processing, but also include some light manufacturing operations, and business services.

In these meetings, issues such as business registration, import and export procedures, licensing requirements, foreign exchange access, etc., will be discussed. Both foreign and domestic export-oriented firms, as well as, partial and indirect exporters will be included. In addition, effort will be directed toward ensuring that the sampling reaches businesses that are operating under, or are knowledgeable of, the various export policy regimes, e.g., the EPZ program, manufacturing-under-bond, export compensation scheme, etc.

These meetings will not only provide additional information on the current policy setting, but can be used as a "reality check" on the data collected through other investigations.

Task 4: Prepare Export Policy Baseline Matrix

Once the work program outlined above has been completed, the Study Team will prepare an Export Policy Baseline Matrix, summarizing the findings of the investigations. The configuration of the Matrix will be determined by the Study Team, but is likely to include the key areas that comprise the policy framework, as well as, implementation or procedural elements, as appropriate, and will encompass the spectrum of targeted programs identified above. To the extent possible, differential policy conditions affecting foreign vs. domestic firms, partial vs. 100-percent exporters, indirect vs. direct exporters, will also be identified.